

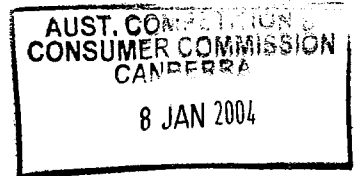


6 January 2004

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Ms Isabelle Arnaud  
Director – Adjudication Branch  
Australian Competition and Consumer Commission  
470 Northbourne Avenue  
DICKSON ACT 2602



**Strictly Confidential**

Dear Ms Arnaud

**Qantas Airways Limited and British Airways PLC  
Applications for Reauthorisation of Restated Joint Services Agreement (JSA)**

I refer to our meeting on 27 November 2003. This letter responds to specific information requested by or discussed with the Commission at our meeting of 27 November 2003.

This letter and the attachments include certain commercially confidential information. Disclosure of that information could result in material financial loss and prejudice the competitive position of the Applicants. Pursuant to section 89(5) of the Trade Practices Act, the Applicants apply for this information to be kept confidential by the Commission and excluded from the register kept by the Commission in accordance with section 89(3) of the Act. For convenience, the confidential information is indicated by the use of bold red square parentheses around confidential text or around the heading of a confidential table or graph.

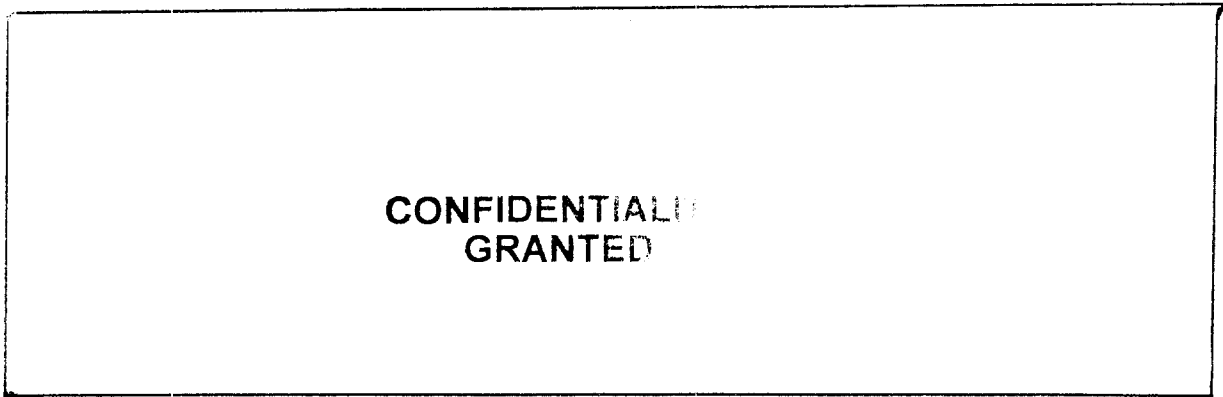
**Analysis of Attachment 7 to our letter of 14 November 2003**

In our meeting of 27 November, the Commission asked Qantas and British Airways (BA) to comment on the trends in each party's yields shown in Attachment 7 of our letter of 14 November 2003 (Attachment 7). We set out some brief comments below.

**Differences between BA and Qantas yields**

The Commission has asked the Applicants to comment on the fact that BA appears from Attachment 7 to have [redacted] for the four years commencing June 1999. There are a number of factors which may have contributed to the differences between each party's yields set out in Attachment 7.

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However, the Applicants consider that the JSA needs to be considered as a joint venture business and therefore, for the purposes of authorisation, it is their combined yield results which are important. These are referred to below.

**Reconciliation of BA's return on sales figures against yield and seat factors in Attachment 7**

The Commission has also asked the Applicants to reconcile the apparent differences in the BA return on sales figures provided at the meeting against BA's yield and seat factor trends in Attachment 7.

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**Table 2**

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**Table 3**

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The individual Qantas and BA revenue per cabin over the period covered by Attachment 7 is set out in Attachment 1 to this letter. This shows the lack of correlation between total revenue and yield in cents per rpk.

Whilst the analysis above focuses on BA and Qantas' individual data so as to address the queries raised by the Commission at our meeting on 27 November 2003, we consider that for the purposes of authorisation it is the combined Qantas and BA JSA results that are important as each carrier's capacity, routing and pricing decisions are a function of combined capacity and yield management.

For ease of reference, we set out below the combined yield data provided in the NECG Report dated May 2003 and in our letter to the Commission of 5 September 2003. This data shows a clear trend downwards in the combined BA/Qantas yields across all cabins and a substantial decline in business and first class yields in recent years. As set out in our letter of 5 September 2003, the business and first class yields do not take into account any back-end rebates paid.

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Clearly, despite ever increasing product standards, the Applicants have not been able to increase average fares over the period of the JSA by a sufficient amount to even keep pace with inflation. Additionally, profitability on JSA routes is low, as shown by Figures 11 and 12 of the NECG Report and BA's return on sales figures above.

**Availability of flexible fares over the internet**

Following Greg Outzen's query in relation to the availability of flexible fares over the internet, we have conducted searches on the internet for a number of random dates in February and have been able to access flexible fares to London in Y and H class on all of those dates. We recognise, however, that it is not easy for consumers using our website to search for international fares other than the cheapest or most flexible. We are currently working on technology enhancements which will provide greater ease for online international sales including modifications which would enable the grouping of international fares into buckets of common conditions (as has been done for our domestic fares).

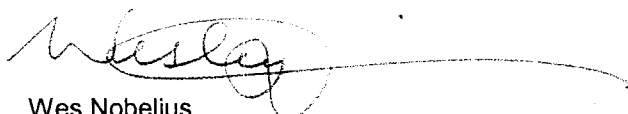
We have also reviewed the Qantas reservation system and found that there is significant availability to London in Y, H and M classes in February.

If you are able to provide specific details of the days and fare classes which Mr Outzen was trying to book, we will look into the issue further.

**Heathrow Slot Information**

A paper prepared by BA on slot availability at London Heathrow Airport is attached as Attachment 2 to this letter.

Yours faithfully



Wes Nobelius  
Deputy General Counsel

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**Attachment 2**  
**Access to London Heathrow Airport for entry or expansion on JSA routes**

The Applicants do not believe that access to London Heathrow Airport is relevant to the competitive analysis of the JSA for the reasons that:

- (a) services to London from Australia do not constitute a separate market – the relevant market is Australia – Europe; and
- (b) in any event, services to Heathrow Airport do not constitute a separate market and other airports such as Gatwick Airport are not capacity constrained.

These reasons are explained in detail in the submission attached to our letter of 12 December 2003.

However, at our meeting with the Commission on 27 November 2003, the Commission advised that it was interested in obtaining more details of slot access at Heathrow Airport. This paper provides these details and shows that even if Heathrow Airport access were relevant, all the evidence demonstrates that access to slots at London Heathrow does not constitute a barrier to entry or expansion on the JSA routes.

**1. Slots on JSA services**

Heathrow Airport has two operating runways. During any given operational time, one is used for arrivals and the other for departures.<sup>1</sup> Together, the runways have a declared capacity between the hours of 0500 and 2100UTC of 679 daily rotations.<sup>2</sup>

Of these permitted arrivals and departures, 27 daily rotations are being used for services to and from Heathrow Airport to Asian/Middle Eastern mid points (Singapore, Bangkok, Kuala Lumpur, Hong Kong, Dubai, Bahrain, Osaka and Narita) and Australia by the airlines currently serving Asia, Australia and the Middle East from Heathrow.

As demonstrated by the following tables these services have been able to grow and are widely dispersed among individual carriers and alliances.

**Table 1: Growth of LHR – Asia/Middle East/Australia Annual Frequencies**

	1997	1998	1999	2000	2001	2002
SQ	730	848	1047	1098	1095	1095
TG	365	394	521	523	522	528
MH	812	759	730	732	824	939
EK	782	730	914	1100	1128	1339
CX	577	654	710	731	730	835
Others	8265	8182	8396	8359	8404	8167

Notes: Annual frequency for major carriers ex LHR to Australia.  
Others is made up of non-European carriers that can offer one stop services to Australia via a home city/airport  
British Airways' and Qantas' JSA Services each currently account for 1095 annual frequencies.

<sup>1</sup> Mixed mode operation, under which runways are used for both landings and take-offs, is currently used at Heathrow between the hours of 06:00 and 07:00 to provide additional capacity.

<sup>2</sup> This total is based on an average of the total number of daily departures and arrivals in Summer 2004. A daily rotation consists of two slots: one for arrival of an aircraft and another for its departure.



**Table 2: Carriers serving Australia via Middle - East/Asia from London Heathrow  
(total weekly arrivals and departures & growth in slots)**

	s93	s94	s95	s96	s97	s98	s99	s00	s01	s02	s03	s04	growth
Singapore via SIN	30	30	30	32	32	38	46	46	46	48	48	48	60%
JAL via NRT/KIX	26	26	36	30	38	44	44	40	38	40	36	48	85%
Malaysia (Virgin Codeshare) via KUL	14	14	28	28	28	32	28	28	32	36	36	36	157%
Emirates via Dubai	14	28	28	28	28	28	42	42	42	42	42	42	200%
Austrian via VIE	46	44	46	44	46	54	48	50	50	48	66	68	48%
Cathay via HKG	28	30	26	32	32	36	36	36	35	44	44	50	79%
Thai via BKK	14	14	14	14	14	14	20	20	20	20	22	26	86%
Gulf Air (from s04) via BAH	52	52	52	52	52	54	54	54	54	52	54	68	31%
Korean via ICN	8	16	10	10	12	12	14	11	12	14	14	16	100%
Royal Brunei via BWN	4	4	8	8	14	14	14	14	14	14	14	14	250%
Virgin Atlantic	71	118	113	124	168	171	192	198	215	190	226	244	244%

## 2. Availability of Slots

Carriers may obtain slots at Heathrow both from the "slot pool" and by "slot exchanges" or can redeploy existing slots to optimise their use.

### A. Availability of Slots from the Pool

Each traffic season Airport Coordination Limited (ACL), the slot coordinator for all U.K. coordinated airports, gathers available slots into a "slot pool" from which it then allocates slots to applicant carriers. ACL is required (as are slot coordinators at all designated European airports) to comply with the provisions of EC Slot Regulation EC 95/93. This regulation provides that 50% of the slots available for distribution in any given season must be allocated to "new entrants."<sup>3</sup> Carriers that currently enjoy new entrant status at Heathrow Airport include Air New Zealand, China Eastern, Korean Air and Thai International. If new entrants do not take all of the slots set aside for them, the remaining slots are allocated to incumbents. Thus, a significant percentage of new slots allocated each year are granted to "new entrants."

There are four sources of slots available from the pool for allocation by the coordinator for airlines wishing to start new services from Heathrow. These four sources include: (1) unused slots from the existing slot pool, (2) new slots that become available through increases in Heathrow capacity, (3) slots returned to the pool under the "use-it-or-lose-it" rule and (4) slots arising from cancellations of service or current carriers failing to apply for historical slots.

One of the sources of "pool" slots is newly declared capacity which has become available over the last several years as existing air traffic control resources, runways and other facilities are utilised more efficiently. This optimisation creates new slots that are made available to incumbents and new entrants through a process administered by the independent slot coordinator.

Between 1995 and 2003, the number of slots available in the summer traffic season increased from 631 to 678 daily rotations.

<sup>3</sup> Council Regulation 95/93/EEC on common rules for the allocation of slots at Community airport, Article 10(7). Article 2 (b) of the Regulation defines "new entrants" as those carriers that, upon requesting a slot on any day, hold or have been allocated fewer than four slots on that day at the airport in question.

**Table 3: New Slots Available at Heathrow 1995-2003 Summer Season (daily arrivals and departures)**

	Peak	Off-Peak	Total
1995 capacity	1,158	105	1,263
2003 capacity	1,222	135	1,357
Capacity increase 1995-2003	64	30	94
New capacity peak/off-peak split	68%	32%	100%

Source: ACL

In addition to newly created capacity, slots become available for allocation through the slot pool as carriers return or forfeit slots. Slots are routinely returned as carriers make schedule changes by swapping their existing slots for those held by others. Slots also revert to the pool if not properly used under "use-it-or-lose-it" principles. As indicated below, through new capacity, returns and forfeitures, slots equivalent to 210 daily rotations were allocated during a typical peak summer week for the period from 1996 through 2003.

**Table 4: Average Daily Rotations Available/Allocated Through Pool**

	1997	1998	1999	2000	2001	2002	2003
Available	55	50	42	34	30	33	30
Allocated	30	28	28	25	24	23	19
Cumulative allocated <sup>4</sup>	63	91	119	144	168	191	210

Source: ACL

As shown by Table 2 above, a number of carriers serving Asia, the Middle East and Australia have picked up new slots at Heathrow through the slot pool in recent years. In addition, in relation to Northern Summer 2004:

- Qantas was successful in obtaining two new early morning arrival slots on a Saturday and Sunday at Heathrow;
- Virgin Atlantic obtained three slots for a new service to Kuala Lumpur, although we understand that it may be leasing these slots to Malaysia Airlines in the short term;
- the following Asian carriers all obtained new slots at Heathrow: Cathay Pacific (three), Eva Air (one), Air China (one), JAL (six), Korean Airlines (one), China Eastern (three); and
- Phuket Air, a new carrier, obtained three slots at Gatwick.

#### **B. Additional Mechanisms for acquiring slots**

Although, as noted above, slots are available from the pool for both new entrants and incumbents, the number of available slots is not unlimited and there are other mechanisms for acquiring slots outside of the slot pool process and for improving slots obtained from the pool. It has been the Applicants' experience that there have been increasing examples of slot 'trading' at Heathrow in recent years. All of these slot acquisition methods have permitted a number of new carriers to commence operations at Heathrow and have made it possible for carriers to increase the frequency of services from Heathrow to Asian, Middle Eastern and Australian destinations.

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<sup>4</sup> Since 1996

There are a number of ways in which carriers can and do obtain slots outside of the slot pool:

### **Slot exchanges**

Slot exchanges are common practice at Heathrow and provide opportunities for a new entrant with no slots to obtain slots or exchange their existing slots for slots with more desirable times. Carriers attend the IATA Schedule Conference in advance of each traffic season to optimise their respective schedules, frequently by engaging in mutually beneficial one-for-one swaps of slots with other carriers. Slots allocated to a carrier may not be pieced together to occur at exactly the same time on each day of the week, but by swapping with other carriers consistent timings can be obtained. Similarly, "off-peak" slots can be improved to "peak" times, and when the perceived value of the slots exchanged differs, the slot regulations do not prohibit the counter-party receiving the more valuable slots from paying monetary consideration for the exchange. This practice was confirmed by the U.K. High Court in 1999. During the IATA Schedules Conference for Summer 2004 held in November 2003, British Airways believes that the following airlines were involved in exchanges involving off-peak slots: [REDACTED]

### **Deferred slot exchanges**

Where an airline has been allocated slots at timings that don't meet its aspirations, the slots may still present an opportunity for the airline to operate a service. Over time, the carrier can seek to steadily improve the timings through the methods described in this submission. Carriers that have no current requirement for a slot held at a time can exchange that slot with another carrier, entering at the same time into an agreement that commits the counterparty to do a reverse exchange at a future date. These exchanges (often referred to as "leases") can again, as a matter of English law, be accompanied by monetary consideration.

### **Slot Sharing**

It is also possible for carriers with a "joint operation", such as a codeshare arrangement, to effectively share slots. The IATA Worldwide Scheduling Guidelines allow a carrier to operate a slot held by another carrier for their shared operation. Data published by ACL on slots held by carriers at Heathrow suggest that Virgin and Malaysia Airlines have an arrangement whereby Virgin hold 3 slot pairs per week but they are operated each season by Malaysia Airlines. Two of these pairs have early morning arrivals. As more and more carriers join alliances in which codesharing is highly prevalent, this mechanism may be used within alliances to optimise slot portfolios, particularly where the alliance partners have antitrust immunity and are thus able more easily to share revenues and otherwise act as a single firm.

In conclusion, all those carriers wishing to set up operations from Heathrow on JSA routes are able to obtain at least some slots through one form of slot trading or another.

### **C. Re-Deploying Slots to Service Asia/Middle East/Australia markets**

Carriers can and do allocate slots to their most profitable use. If any route earns higher profits than others, carriers will naturally allocate a greater proportion of their slot allocations to that route. It follows that, carriers operating services from Heathrow to multiple destinations can readily allocate slots to services to Asia, the Middle East and Australia if it is profitable for them to do so.